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INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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JASincavage

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to: Commissioner, Tax-Exempt and Government Entities

from: Edward F. Cronin *Edward F. Cronin*
Division Counsel/Associate Chief Counsel (Criminal Tax)

subject: Rule 6(e) and *Tweel* Issues that May Arise in the Context of Joint Civil and Criminal Investigations

Background

There may be times when Criminal Tax (CT) and Tax-Exempt and Government Entities (TEGE) are investigating the same taxpayer or transaction for potential abuse. As a result, several issues may arise including Federal Rule of Criminal Procedure Rule 6(e) (Rule 6(e)) grand jury secrecy issues as well as *Tweel* concerns. In consideration of these issues, there may be instances where it is necessary to create a wall between civil and criminal tax functions.

FRCP Rule 6(e) Grand Jury Secrecy

It is anticipated that grand juries may be used to investigate tax exempt entities. FRCP Rule 6(e) limits the use of grand jury material to enforce criminal laws. Specifically, matters occurring before the grand jury may not, absent limited exceptions, be disclosed. Violation of Rule 6(e) may result in contempt charges or motions to dismiss an indictment. Therefore, civil and criminal functions must use caution when sharing information in a criminal case conducted through a grand jury.

"Matters occurring before a grand jury" include:

- (1) Information revealing the scope or direction of the investigation;
- (2) The identity of targets or witnesses;
- (3) Grand jury transcripts; and,
- (4) Things that occurred before the grand jury.

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Evidence gathered prior to grand jury referral, however, is not Rule 6(e) protected material even if the evidence is eventually presented to the grand jury. Additionally, evidence obtained independently of the grand jury that has been obtained without disclosure as to the existence of a grand jury does not invoke Rule 6(e) even though the grand jury was pending at the time the evidence was developed. It is important to segregate administrative information prior to receipt of grand jury information. Thus, all independently obtained information should be kept separate and all grand jury information should be clearly labeled.

There are exceptions to Rule 6(e). For example, grand jury information may be disclosed to government attorneys for use in the performance of that attorney's duty or to other government personnel as deemed necessary to assist the government attorney in the performance of such attorney's duty to enforce the federal criminal law. Every decision to release or share evidence gathered during a grand jury investigation must be made on a case by case basis. The final decision concerning whether to share such information should be deferred to the Department of Justice (DOJ) official in charge of the grand jury.

FRCP 6(e)(3)(C)(i) provides for the disclosure of matters otherwise prohibited by Rule 6(e) may be made when so directed by a court "preliminary to or in conjunction with a judicial proceeding. The Supreme Court held that a tax audit was not preliminary to or in conjunction with a judicial proceeding within the meaning of Rule 6(e)(3)(C)(i). See *United States v. Baggot*, 463 U.S. 476 (1983); *United States v. Sells Engineering, Inc.*, 463 U.S. 418 (1983).

Civil Audits

Oftentimes, cases are initially developed through information obtained civilly and through the use of revenue agents. As information develops, these cases sometimes change from civil to criminal investigations. As a result of the civil/criminal overlap, defendants have made the argument that the IRS was using revenue agents as mere "stalking horses" for criminal investigations and circumventing defendants' Fourth Amendment protections. These types of challenges took the form of motions to suppress evidence, motions to dismiss the indictment, and motions to deny enforcement of civil subpoenas. In 1977, these concerns were formally addressed by the Fifth Circuit.

United States v. Tweel

In *United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977), the Fifth Circuit held that the government cannot affirmatively mislead a taxpayer into consenting to a search by agreeing to provide information during a civil audit by engaging in fraud, trickery, or deceit. If the government does so, the consent will not be valid and the "search" will

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violate the Fourth Amendment resulting in the exclusion of such evidence in the criminal case. The Fifth Circuit emphasized that "[o]ur revenue system is based upon the good faith of the taxpayers and the taxpayers should be able to expect the same from the government in its enforcement and collection activities." *Id.* at 300.

In *Tweel*, a civil audit of the defendant was requested by the Organized Crime and Racketeering Section of the DOJ. During a telephone conversation between the revenue agent conducting the audit and the defendant's accountant, the accountant asked the agent whether a special agent (denoting the criminal nature of the inquiry) was involved in the case. The revenue agent responded that no special agent was involved. The accountant took the answer to mean that the audit would be a routine civil audit. The court found that the agent's failure to advise the attorney of the "obvious criminal nature" of the audit was a "sneaky deliberate deception" and "flagrant disregard" for the defendant's rights.

Notwithstanding the result in *Tweel*, the Fifth Circuit stated:

We conclude that the mere failure of a revenue agent (be he regular or special) to warn the taxpayer that the investigation may result in criminal charges, absent any acts by the agent which materially misrepresent the nature of the inquiry does not constitute fraud, deceit, and trickery. Therefore, the record here must disclose some affirmative misrepresentation to establish the existence of fraud, and the showing must be clear and convincing.

Tweel, 550 F.2d at 299, citing *United States v. Prudden*, 424 F.2d 1021, 1033 (5th Cir.), *cert. denied*, 400 U.S. 831 (1970).

Traditionally, *Tweel* arguments fall into two distinct categories:

- (1) Did the IRS conduct a criminal investigation under the guise of a civil audit?
- (2) Did the revenue agent violate the Internal Revenue Manual by not referring the case to Criminal Investigation (CI) at an earlier time?

Since *Tweel*, criminal defendants have alleged that civil agents have made affirmative misrepresentations because of what they said or didn't say. In *United States v. Kaatz*, 705 F.2d 1237 (10th Cir. 1983), the Tenth Circuit held that evidence obtained by an IRS agent during a civil audit of the defendants was not subject to suppression in a subsequent criminal prosecution since nothing in the record indicated that defendants were misled by anything the agent did or said, and since failure to warn that a criminal investigation may ensue is not fraud, deceit, or trickery. The court further found that the agent's violation of the "Audit Technique Handbook for Internal Revenue Agents" did not violate any constitutional right of the audited individual. See also *United States v. Caceres*, 440 U.S. 741, 744-745 (1979).

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Criminal defendants may claim that revenue agents violated *Tweel* because they continued civil audits even though there were sufficient indicia of fraud to warrant referral of the case to CI. This defense centers on whether the revenue agent violated IRS policy by not referring the case to CI upon a finding of fraud. An example of such a case, albeit a district court holding, applying the firm indication of fraud concept to the detriment of the government is *United States v. Toussaint*, 456 F.Supp.1069 (S.D. Texas, 1978). In *Toussaint*, the district court held that where a revenue agent, after having a firm indication of fraud, continued his investigation for a considerable period of time without advising the taxpayer that the information being collected could be used for criminal prosecution, there was a violation of the taxpayer's Fourth and Fourteenth Amendment rights. As such, suppression of admissions or statements made by the taxpayer during interviews held by the revenue agent after finding firm indications of fraud was required.

Creating a Wall between Civil and Criminal Functions

In an effort to comply with Rule 6(e) and *Tweel*, the IRS applied the concept of a "Chinese wall" where civil and criminal functions may be involved in the same investigation at different stages. A "Chinese wall" is a term of art used in law to describe a situation in which one part of a law firm, representing a party on a deal or litigation, is kept separate from another part of the law firm that might otherwise have an adverse effect on the party's interests. Here, the term is used to denote a separation between the civil and criminal functions of the IRS to ensure that evidence for use in a criminal investigation is not developed under the guise of a civil investigation.

Under IRS guidelines, a CI special agent may not participate in a civil audit. However, a revenue agent may participate in a joint investigation with CI. Attempts to pursue the criminal and civil aspects of a case concurrently can jeopardize successful prosecution of a criminal case. Historically, the Service's policy provided that the criminal aspects of a case took precedence over the civil aspects and any civil enforcement action involving the same tax and periods as an active criminal investigation were suspended or deferred until the criminal aspects of the case were closed. *United States v. Peters*, 153 F.3d 445, 454 (7th Cir. 1998). Subsequent to the *Peters* case, the IRS revised its policy and issued Policy Statement P-4-26. The policy now provides that while it may be necessary in the interest of criminal enforcement to identify those instances where criminal actions will take precedence over civil aspects, it is also necessary to identify those instances where civil and criminal actions should be coordinated to curtail abusing promoters and return preparers. Thus, a balancing test now applies to the priority of civil versus criminal enforcement.

The Seventh Circuit in *Peters* held that "[a]ctive involvement of CID personnel in a civil audit prior to the completion of a criminal referral also has been treated as compelling evidence that the IRS has proceeded beyond the point of "the firm indications of fraud"

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and attempted to use the audit as a covert criminal investigation. See *United States v. Caldwell*, 820 F.2d 1395, 1399 n. 4 (5th Cir.1987); *United States v. Robson*, 477 F.2d 13, 17 (9th Cir.1973); *United States v. Smith*, 898 F.Supp. 464, 468 (W.D.Ky.1995); *United States v. Piper*, 681 F.Supp. 833, 838 (M.D.Ga.1988). This principle has its roots in the fact that the IRS, in an effort to comply with Tweel and its progeny, has constructed a "Chinese wall" between its civil examination and criminal investigation divisions. Indeed, IRS guidelines specifically warn that revenue agents who are in the process of determining the appropriateness of a criminal referral must not obtain evidence and/or direction from the Criminal Investigation Division for a specific case that is under examination. Conversely, a special agent who refers a case to the Examination Division as lacking in criminal potential must withdraw from the case under most circumstances. *Peters*, 153 F.3d at 454.

Section 25.1.5 of the Internal Revenue Manual (Grand Jury Investigations)¹ sets forth the rules for transferring an investigation from the civil to the criminal and the procedures for establishing a "Chinese wall" between the two functions for the duration of the criminal investigation.

¹ We note that P-4-26 was issued after the last update to IRM Section 25.1.5 rendering some of its provisions obsolete.